

**TESTIMONY**  
**of the**  
**American Medical Association**  
**before the**  
**Special Committee on Aging**  
**United States Senate**

**RE: “Health Saving Accounts and the New Medicare Law:  
The Face of Health Care’s Future?”**

**May 19, 2004**

Mr. Chairman, my name is Edward L. Langston, MD, Trustee of the American Medical Association (AMA). I am a practicing family physician in Lafayette, Indiana. On behalf of the Association and its physician and student members, I thank you for the opportunity to share our views with the Committee regarding newly created Health Savings Accounts (HSAs), which are an expansion of their predecessor, Medical Savings Accounts (MSAs). We especially thank this Committee for holding this hearing and continuing to focus attention on the nation’s health, particularly the health of older and/or retired Americans.

The AMA has long been a champion of MSAs, a consumer-driven health care option. They provide affordable protection against high medical costs, greater patient control over use of health services, assistance with the patient-physician relationship, and incentives to utilize health care in a cost-conscious manner. We support the newly created HSAs, and we are appreciative of the U.S. Department of the Treasury’s and U.S. Department of Labor’s timely issuance of their regulatory guidelines.

A main element of AMA’s proposal for expanding health insurance coverage is creating opportunities for individuals and families to access alternative markets for the purchase of individually owned health insurance. This hearing is an important step in exploring such consumer-driven health care options for our nation.

AMA Supports HSAs

Both MSAs and HSAs are a form of health insurance coverage that includes a high-deductible insurance plan coupled with a tax-advantaged personal savings account to be used only for qualified medical expenses. Under the options, patients have incentives to utilize health care in a cost-conscious manner because they spend from their own accounts and/or out-of-pocket before meeting the deductible. Unspent account balances accumulate and accrue interest from year-to-year. High deductibles keep premiums low, making coverage more affordable than traditional insurance and freeing up monies to fund the accounts. Once the deductible has been met, coverage resembles conventional insurance. HSAs can result in administrative savings to the extent that services utilized before the deductible are not sent through claims processing. Account funds also can finance long-term care with untaxed dollars and serve as retirement savings for non-medical expenses, though subject to income tax upon withdrawal.

According to the Internal Revenue Service, nearly 75% of MSA enrollees had been previously uninsured. The AMA and other MSA supporters sought to make MSAs permanent and eliminate restrictions hindering their growth. Legislation passed in 2001 and 2002 renewed the MSA demonstration through the end of 2003. In December 2003, the “Medicare Prescription Drug, Improvement, and Modernization Act” (P.L. 108-173) (MMA) established HSAs effective January 1, 2004, thereby removing most MSA restrictions. The establishment of HSAs is part of an overall trend toward consumer-directed health care, in which patients have greater control over health care decision-making and gain a better understanding of the financial consequences of their decisions.

Almost immediately after the passage of the MMA, the U.S. Department of the Treasury issued guidance on the implementation of HSAs, followed by further guidance from the Department in March 2004 and May 2004. The U.S. Department of Labor issued its Field Assistance Bulletin in April 2004. Treasury has stated that it will release more formalized guidance or regulations in 2005.

Since the authorization of HSAs, employers, insurers, financial institutions, policy makers, and the media have shown intense interest in HSAs. We are hopeful that HSAs will assist with restraining health care utilization, exerting competitive pressure on prices, and forcing transparency of pricing. We are encouraged that HSAs possibly will cut the ranks of the uninsured, boost innovation in benefit design, and spur demand for cost-containing medical technology. Moreover, we anticipate that HSAs could reduce managed care interference in treatment decisions and restore the patient-physician relationship.

The AMA supports the permanent establishment of HSAs by the “Medicare Prescription Drug, Improvement, and Modernization Act” and subsequent regulatory guidance. The statute and regulations substantially achieve many of the AMA’s policy objectives for MSAs/HSAs. We especially support the following elements of HSAs:

- Repealing the limit on the number of MSAs (hereafter called HSAs) and removing the demonstration status of the project;
- Expanding eligibility to employees of any size employer and to any individual;
- Allowing both employees and employers to contribute to HSAs;
- Allowing annual HSA deposits up to 100% of the deductible, with no limit on the fraction that can be deposited at any time during the year;
- Reducing the permitted annual minimum deductibles and allowing higher annual maximum deductibles;
- Allowing HSAs to be offered in cafeteria plans provided by employers;
- Extending a “safe harbor” to high-deductible plans in all states to allow for the coverage of preventive services regardless of whether the deductible has been met; and
- Making HSAs available from a wide variety of sources, including banks, brokerage houses, and health insurers.

#### HSAs Enhance the Patient-Physician Relationship

High-deductible health insurance policies provide patients and their physicians an incentive to avoid wasteful health spending. When spending comes from the patient’s personal HSA, patients and their physicians have a strong incentive to balance the costs of medical procedures against the potential favorable impact on health. The same enticement can influence the choice among hospitals and among different prescription drugs. Because these cost incentives reduce the need for HMO rules that limit the availability of care, individuals can have greater flexibility for choosing the care that they want. In short,

the new HSA tax and insurance rules may be the beginning of successfully controlling medical spending and bringing it in line with the best interests of patients.

### Effects of HSAs on Cost and Access

#### ***Demand for HSAs Among Individuals***

The loosening of eligibility restrictions vastly increases the potential market for HSAs. Eventually, demand for HSAs is likely to be particularly strong among workers whose employers do not offer health insurance benefits – the group that accounts for the majority of the uninsured. During the first week of 2004, one insurer received over 1,000 applications for HSAs, and during the first six weeks of the year, 30% of their new HSA enrollees were among the *previously uninsured*. HSAs also have the potential to expand coverage by funding premium payments for workers who lose their jobs.

The lowering of required deductibles also makes HSAs appeal to more people, especially given that there is already a trend toward higher deductibles. Given limits on out-of-pocket expenditures, even frequent utilizers of health care services could be attracted to HSAs as a means of wresting control over health care decisions from managed care insurers. The fact that HSA health plans are now permitted to exempt a wide array of preventive services from the high-deductible will also make HSAs more attractive to many individuals and families. It should be noted that some analysts worry that families might be deterred from purchasing an HSA because, in contrast with insurance industry norms, plans generally may not apply lower embedded individual deductibles to individual family members.

Individuals will be attracted to HSAs both for insurance coverage and as an investment vehicle, since HSA contributions and interest earnings are not taxed and individuals own and control the investment choices. Even if HSA funds are not rolled over to the following year, the individual reaps a tax advantage by paying for out-of-pocket medical expenses with untaxed dollars. The tax advantages of HSAs, although generally greater for those in higher tax brackets, are substantial for anyone earning enough to pay income taxes.

#### ***Demand for HSAs Among Employers***

Employers seeking to rein in rapidly escalating health benefit costs – or simply offer health benefits – will be attracted to HSAs. In a 2003 survey of small business owners conducted by the National Small Business Association, 73% of respondents reported that HSAs would appeal to their employees. A recent survey of large employers indicates rapid growth in the number of firms offering employees a consumer-driven health care plan.

Because of the timing of the HSA regulatory guidance relative to open-enrollment periods, some employers were unable to offer HSAs in 2004; yet there is expected to be a large wave of employers offering HSAs in 2005. In April 2004, the federal Office of Personnel Management announced that, starting in 2005, HSAs will be offered to the nearly nine million federal employees and their dependents covered through the Federal Employees Health Benefits Program. Employers offering HSAs alongside other health plan choices are likely to adjust premiums and benefits in order to mitigate any adverse selection across plans.

#### ***Supply of HSAs by the Insurance and Financial Services Industries***

In early 2004, demand for HSAs on the individual market seemed to outpace supply, with some individuals having difficulty finding knowledgeable, qualified banks or other institutions with which to establish accounts (hence, the Department of Treasury granted transition relief guidance allowing extra time to establish HSAs). Many insurers planning to market HSA accounts along with their insurance

plans will start by offering simple accounts and later offering more sophisticated investment options. At least one company already plans to issue debit cards for HSA, MSA, and Flexible Spending Arrangements (FSA) that would verify patient eligibility and track deductibles. Although some insurers are awaiting final regulatory guidance, most industry experts expect the availability of HSA plans and accounts to expand rapidly, as was the case following the liberalization of IRA eligibility restrictions in 1981.

In a recent survey of insurers serving employer groups, 42% of respondents reported having an HSA product either ready or under development, with another 25% considering entering the HSA market. The first insurers offering qualifying high-deductible health plans have been companies already offering MSAs or Health Reimbursement Accounts (HRAs). The large carriers tend to offer plans with a wide range of benefit designs, some already complying with HSA requirements. Large carriers were already positioned to serve as HSA account custodians and to educate and mobilize brokers to market HSAs. Large carriers also are reportedly working with large employers to develop sophisticated benefits packages that integrate HSAs with HRAs and/or FSAs, to the extent that the Department of Treasury Guidance permit such arrangements.

#### Criticisms of HSAs Appear to be Unfounded

The major criticism of HSAs is that they are only for the “healthy and wealthy.” Based on the limited available evidence to-date from MSAs and HRAs, *this concern has not been borne out*. A simulation model developed by the RAND Corporation suggested that MSAs would not disproportionately attract younger, healthier individuals. At a February 2004 Galen Institute forum on consumer-directed health care, six insurers presented data showing that HRA enrollees were older and of slightly poorer health status as those opting for other forms of coverage. Similarly, there is evidence that, despite chronic conditions or high medical expenses, some people are attracted to HRAs because they gain greater control over health care decisions than under conventional managed care plans.

Calculations conducted by the AMA show that the annual cost of an HSA compared to a PPO plan depends on health plan premiums, deductibles, coinsurance, and out-of-pocket limits, as well as individual medical expenses and tax bracket. Not surprisingly, individuals with little or no medical expense generally save money with an HSA because of the premium difference. Individuals with moderate to high medical expenses are more likely to find the PPO less expensive. However, two factors in addition to low premiums could make an HSA more affordable than conventional coverage even for those with higher expenses. First, although generally higher than PPO out-of-pocket limits, the HSA out-of-pocket limit serves as a powerful protection against catastrophic loss. Second, out-of-pocket expenses funded by an HSA are paid for with untaxed dollars. Because of this tax advantage, some individuals may find an HSA less expensive than the PPO regardless of their medical expenses.

One must consider how an HSA compares to alternative health plans. People with high medical expenses will pay attention not only to their overall costs – which could be lower with an HSA than conventional coverage – but also to gaining greater choice and control over physicians and treatment decisions, an advantage of HSAs.

#### Future Congressional Action

The AMA strongly supports the newly created HSAs. As previously stressed, we applaud both the statute and corresponding Guidance provided through the regulatory process through the Department of Treasury

and the Department of Labor. Additionally, AMA supports the following which would make HSAs even more attractive to patients:

- Allowing early retirees and others who are unemployed but not receiving unemployment compensation to use account funds to pay for high-deductible health insurance premiums, without being taxed or penalized the 10% fee.
- Allowing patients to receive tax-free rollovers of unspent Flexible Spending Arrangement (FSA) funds to go into a FSA or into a HSA. This would promote more prudent healthcare spending by curtailing the “use it or lose it” mentality promoted by current law.
- Allowing high-deductible health insurance plans issued to families in conjunction with HSAs to apply lower, per-person deductibles to individual family members with: (1) the permitted levels for per-person deductibles being the same as permitted levels for individual deductibles; and (2) the annual HSA account contribution limit being determined by the full family deductible or the dollar-limit for family policies.

#### AMA Thanks the Committee

We thank the Committee for exploring the issue of consumer-driven health care and in particular HSAs. We look forward to working with the Committee on the issue of HSAs and other important health care objectives.